

**Pricing Discrepancies on the Long Term  
Maintenance Computing Center Contract  
(TIR-NO-96-D-0021)**

**October 2001**

**Reference Number: 2002-10-008**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

October 17, 2001

MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES

*Scott E. Wilson*

FROM: (for) Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Pricing Discrepancies on the Long Term  
Maintenance Computing Center Contract (TIR-NO-96-D-0021)  
(Audit # 200110038)

This report presents the results of our review of the long term maintenance computing center contract. The overall objective of this review was to determine whether an allegation regarding pricing discrepancies for contract TIR-NO-96-D-0021 could be substantiated.

In summary, we found that the contractually agreed upon price for specific contract line items was incorrectly priced by the contractor and/or its subcontractor. Specifically, the Internal Revenue Service (IRS) was billed monthly for the yearly costs of maintenance coverage for nine contract line items. Additionally, the IRS paid for a higher priced software upgrade than that provided by the contractor. Approximately \$580,000 was associated with these billing discrepancies. We presented the results to an Assistant United States (U.S.) Attorney, who considered the prosecutable merits of the case. After consulting with the contractor's legal counsel, the Assistant U.S. Attorney declined civil and criminal prosecution.

Management's Response: Procurement management agreed with the results and conclusions presented in this report. However, their avenues to recoup the costs are limited. The contract is completed and the contractor holds no other contract with the IRS. In addition, the contractor has filed for Chapter 11 in the U.S. Bankruptcy Court. Procurement management and IRS legal counsel agree that it is not in the best interest of the IRS to expend resources to file and support a claim against the contractor through the Department of Justice and the bankruptcy court system. As an alternative, the IRS did issue a letter to the contractor requesting an equitable adjustment. However, given the contractor's bankruptcy status, recouping any costs is unlikely and

will be a lengthy process. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as Appendix IV.

Copies of this report are being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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## **Pricing Discrepancies on the Long Term Maintenance Computing Center Contract (TIR-NO-96-D-0021)**

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### **Background**

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The Internal Revenue Service (IRS) awarded a Long Term Maintenance Computing Center (LTMCC) contract to provide on-call remedial maintenance, preventive maintenance, and support services for Federal Information Processing resources at the Detroit and Martinsburg Computing Centers and the IRS National Headquarters. Equipment and software coverage under this contract was needed to provide uninterrupted support for all equipment and software associated with the agency's information processing system at these sites.

The LTMCC contract was competitively awarded to a contractor on June 1, 1996, through the 8(a) set-aside program. The contract was for 1 year with the option to renew for 4 more years. The software licensing and maintenance requirements portion of the contract was for firm fixed price indefinite delivery.

The audit work was performed from April to October 2000 at the IRS Procurement Office in Oxon Hill, Maryland. The issuance of the audit report was delayed at the request of an Assistant United States (U.S.) Attorney who was considering the prosecutable merits of the case.

The scope of our audit was limited to reviewing this allegation and the events surrounding the contractor's selection and administration of the contract. Audit tests included reviewing contracting and subcontractor records and interviewing contracting personnel associated with the contract. Since the audit was initiated in response to a complaint, we did not follow all of the standards for planning. However, all other components of the audit were performed in accordance with *Government Auditing Standards*.

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### **Pricing Discrepancies With the Monthly Software Maintenance**

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The Treasury Inspector General for Tax Administration (TIGTA) Office of Investigations received an allegation that the contractor had mischarged the IRS for monthly software maintenance fees. As part of this review, the TIGTA subpoenaed select subcontractor records to try and substantiate the allegation.

The subpoenaed subcontractor records indicated that the IRS was mischarged on the following Contract Line Items

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(CLIN): 24075, 24085, 26030, 26035, 26066, 26067, 26068, 26069, and 23044. The subcontractor records indicated that these services were provided to the contractor at a significantly lower cost than that for which the IRS was billed.

Prior to contract award, the contractor teamed with a subcontractor to help bid on the LTMCC contract. The subcontractor had been the previous contractor on the LTMCC contract but was precluded from bidding on this contract because it had graduated from the 8(a) program. As part of the teaming agreement, the subcontractor was responsible for all software maintenance and software management activities for the program. The subcontractor was also responsible for providing proposal support for technical and cost proposals.

During the IRS' solicitation for bids, there was confusion by prospective bidders regarding the pricing of CLINs and the information requested by the IRS. Therefore, concurrent with a solicitation amendment, the IRS issued responses to contractor questions that notified prospective bidders to reflect monthly prices in bid submissions.

After the bidders submitted their best and final offers, the IRS price analyst reviewed the bids for price reasonableness. The analyst compared the software maintenance and upgrade tables as one price between bidders and substantiated pricing consistency, price realism, and price reasonableness at the total price level.

Based on the best value determination, the contractor was awarded the contract in June 1996. According to IRS contracting personnel, the contractor representation that the proposed fees were monthly, and that the fees consisted of the contractor's cost plus a fixed percent mark-up, were material to the award decision. At the time of award, CLINs 24075, 24085, 26030, 26035 were incorrectly priced. The IRS subsequently modified the contract by adding CLINs 26066, 26067, 26068, 26069, and 23044 to the contract, and based the price reasonableness of these additional CLINs on the prior subcontractor contract prices. However, this subcontractor had inappropriately priced these CLINs in the previous contract.

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### **The Internal Revenue Service Was Mischarged for a One-Time Software Upgrade**

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According to available documentation, it appears that the subcontractor advised the contractor in May 1997 about inadvertently charging the IRS the yearly estimates on a monthly basis for the nine CLINs. However, we found no documentation that the contractor notified the IRS of the errors or that the contractor adjusted its monthly billings to compensate for the errors. This practice of charging the annual maintenance fee on a monthly basis resulted in the IRS unnecessarily paying the contractor \$433,000 over the life of the contract.

The IRS paid for a higher-priced software upgrade than that provided by the contractor. The IRS ordered a specific CLIN upgrade; however, the contractor replaced the item ordered by the IRS with another, lower-priced product.

In July 1997, the IRS ordered CLIN 30295 IBM SAA AD/CYCLE C/370 product upgrade for approximately \$199,500. The subcontractor notified the contractor that a different product was being proposed and that there was no CLIN for this upgrade in the original proposal. The subcontractor stated that the proposed one-time charge was a completely different product from that stated in CLIN 30295.

Available documentation indicated that the subcontractor billed the contractor for the proposed software upgrade versus CLIN 30295. The cost to the contractor for this one-time upgrade was \$46,908. Therefore, the estimated cost to the government should have been approximately \$52,500, allowing the contractor a modest increase for general and administrative expenses and profit.

We found no indication that the contractor notified the IRS of the product differences. As a result of these product differences, the IRS unnecessarily spent approximately \$147,000 for this one-time software upgrade.

The mischarges on the software maintenance and the one-time upgrade have been discussed with an Assistant U.S. Attorney, who considered the prosecutable merits of the case. After consulting with the contractor's legal counsel, the Assistant U.S. Attorney declined civil and criminal prosecution. This audit report is for informational

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purposes and whatever administrative action the IRS deems necessary.

### **Recommendation**

1. Procurement management should take the necessary administrative actions to recover the questioned costs of \$580,000 associated with the pricing discrepancies for the monthly software maintenance and one-time upgrade.

Management's Response: Procurement management's avenues to recoup the costs are limited. The contract is completed and the contractor holds no other contract with the IRS. Moreover, the contractor has filed for Chapter 11 in the U.S. Bankruptcy Court. Procurement management and IRS legal counsel agree that it is not in the best interest of the IRS to expend resources to file and support a claim against the contractor through the Department of Justice and the bankruptcy court system. As an alternative, the IRS issued a letter to the contractor requesting an equitable adjustment in the amount of \$580,000. However, given the contractor's bankruptcy status, recouping any costs from the contractor is unlikely and will be a lengthy process.



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**Appendix I**

**Major Contributors to This Report**

Maurice Moody, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

John Wright, Director

Nancy LaManna, Audit Manager

Terrey Haley, Senior Auditor

Bobbie Draudt, Auditor

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**Appendix II**

**Report Distribution List**

Commissioner N:C  
Director, Procurement A:P  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Office of Management Controls N:CFO:F:M  
Audit Liaison – Director, Procurement A:P

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**Appendix III**

**Outcome Measures**

This appendix presents detailed information on the measurable impact that our findings will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Questioned Cost – Actual; \$433,000 pricing discrepancies – monthly maintenance fees (see page 1).
- Questioned Cost–Actual; \$147,000 pricing discrepancies – software upgrade (see page 3).

Methodology Used to Measure the Reported Benefit:

- **Monthly Maintenance Fees:** We reviewed subpoenaed documents and determined that for nine contract line items the annual amount of maintenance was charged on a monthly basis. For each of these nine contract line items, we calculated the difference between what the monthly maintenance should have been and what the IRS was invoiced, then multiplied the result by the contract life (60 months).
- **One-time Software Upgrade:** We used subcontractor documentation to ascertain what should have been charged for the product and allowed a modest 12 percent increase for general and administrative (G&A) expenses and profit. We estimated the contractor's cost at \$52,500 (\$46,908 plus the 12 percent G&A and profit increase, rounded); the IRS was invoiced for \$199,500. The difference is \$147,000.

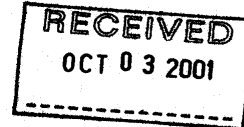
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Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



October 2, 2001

MEMORANDUM FOR PAMELA J. GARDINER  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Gregory D. Rothwell *Gregory D. Rothwell*  
Deputy Chief, Agency-Wide Shared Services

SUBJECT: Draft Audit Report - Pricing Discrepancies on the  
Long Term Maintenance Computing Center (LTMCC)  
Contract (TIRNO-96-D-00021)

Thank you for the opportunity to respond to your draft report. To summarize, the audit was conducted in conjunction with the TIGTA Office of Investigations to determine whether the LTMCC contractor incorrectly priced certain contract line items. The review disclosed that the contract contained inadvertent pricing errors that the contractor did not correct when the errors were discovered. TIGTA presented the findings to the Assistant U.S. Attorney who, after consulting with the contractor's attorney, declined to prosecute the case. We agree with the facts detailed in the draft report.

The report recommends Procurement take action to recover \$580,000 in questioned costs identified by the audit. Unfortunately, our avenues to recoup the costs are limited. The LTMCC contract is completed and the contractor holds no other contract with the IRS. Moreover, the contractor has filed for Chapter 11 in the U.S. Bankruptcy Court.

We would like to point out that IRS awarded the LTMCC contract as the result of a fixed price, best value competition. Under competitive, fixed price, source selection procedures, contract award is made after considering the technical solution and prices to determine the best overall proposal. An individual contract line item price is only a small part of that consideration. The governing principle is that competition ensures fair and reasonable prices. In this case, the contractor proposed the lowest overall price and submitted the highest rated technical proposal.

We have reviewed the facts of this case with legal counsel and agree it is not in the best interests of the IRS to expend the resources to file and support a claim against the contractor through the Department of Justice and the bankruptcy court system. As with any claim against a contractor, we assessed whether we had a case strong

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enough to pursue. The facts in this case are that the contractor was not required to certify against defective pricing, did not fraudulently provide erroneous pricing, and successfully provided products and services as stipulated by the contract. In light of these circumstances and the contractor's current financial status, it is extremely doubtful that we would be successful obtaining compensation. As an alternative, we have issued a letter to the contractor requesting an equitable adjustment in the amount of \$580,000. Our hope is the contractor will seriously consider our request as a good faith effort to repair the perception of poor pricing in the contract. Again, given its bankruptcy status, recouping any costs from the contractor is unlikely and will be a lengthy process.

Since there is no other viable corrective action Procurement can take to recover the questioned costs identified by your audit, we ask that you note the issue as closed in your final report.

We firmly believe the circumstances discussed in the report are not systemic. The Director of Procurement will share the final report with the Procurement staff as lessons learned. The Office of Procurement pursues the highest standards in contracting that we will continue to emphasize.

Please call me at (202) 622-7500 or David Grant, Director of Procurement, at (202) 622-8480 if you have any questions.